

Part IV - Items of General Interest

Rehabilitation Projects Located in Areas Affected by 2005 Gulf Hurricanes

Notice 2006-38

I. PURPOSE

This notice is to advise taxpayers of certain relief provided by the Secretary to taxpayers having rehabilitation credit property located within the Gulf Opportunity Zone (GO Zone), the Rita GO Zone, or the Wilma GO Zone affected by Hurricanes Katrina, Rita, or Wilma in 2005.

II. BACKGROUND

Section 38(b) of the Internal Revenue Code provides a credit against income taxes for certain business credits, including the investment credit determined under § 46.

Section 46 provides that, for purposes of § 38, the amount of the investment credit includes the rehabilitation credit.

Section 47(a)(1) provides that the rehabilitation credit for any taxable year includes an amount equal to 10 percent of the qualified rehabilitation expenditures with

respect to any qualified building other than a certified historic structure. Section 1400N(h)(1), added by section 101 of the Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135, 119 Stat. 2577, increases the credit percentage to 13 percent for qualified rehabilitation expenditures paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2008, with respect to any qualified rehabilitated building located in the Gulf Opportunity Zone.

Section 47(a)(2) provides that the rehabilitation credit for any taxable year includes an amount equal to 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure. Section 1400N(h)(2) increases the credit percentage to 26 percent for qualified rehabilitation expenditures paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2008, with respect to any certified historic structure located in the Gulf Opportunity Zone.

Section 47(b) provides that qualified rehabilitation expenditures with respect to any qualified rehabilitated building shall be taken into account for the taxable year in which the qualified rehabilitated building is placed in service.

Under § 47(c)(1) a qualified rehabilitated building must be a building that has been substantially rehabilitated. Under § 47(c)(1)(C), the term substantially rehabilitated means that the qualified rehabilitation expenditures during the 24-month period selected by the taxpayer must exceed the greater of the taxpayer's adjusted basis in the building or \$5,000. For certain rehabilitations to be completed in phases, the taxpayer may use a 60-month period rather than a 24-month period if the taxpayer completes architectural plans and specifications for the phases of the project before the

rehabilitation begins.

Section 50 provides generally that, if investment credit property (including a qualified rehabilitated building) is disposed of or otherwise ceases to be investment credit property with respect to the taxpayer before the close of the recapture period, a percentage of the credit allowed under § 38 must be recaptured. Casualty losses are dispositions under the recapture provisions.

Section 1.48-1(a) of the Income Tax regulations generally requires “section 38 property” to be property for which depreciation is allowable to the taxpayer. Generally, under § 1.48-1(b), depreciation is allowable to the taxpayer if the property is of a character subject to the allowance for depreciation under § 167.

Section 167 provides generally that depreciation is allowed for property used in a trade or business or held for the production of income. Section 1.167(a)-10(b) provides that the period for depreciation of an asset begins when the asset is placed in service and ends when the asset is retired from service.

Depreciation is not allowed for property that is permanently retired either from service in a trade or business or from being held for the production of income, whether retired because of casualty or otherwise. § 1.167(a)-8(a). Depreciation, however, continues to be allowed for property which has been damaged and is not currently in actual use in a trade or business (or in the production of income) but is not permanently retired from the trade or business (or being held for the production of income) for a reasonable period during which the property is being repaired or restored to service. See § 1.167(a)-8(a). If a qualified rehabilitated building is permanently retired less than

five full years after it was placed in service, the § 47 credit taken by the taxpayer with respect to that property is subject to recapture as provided in § 50. The § 47 credit taken by a taxpayer on a property that is damaged and not currently in actual use does not cease to be section 38 property because of the lack of actual use during a reasonable period in which the property is being repaired or restored.

III. AFFECTED AREAS

This Notice applies to rehabilitation projects located in the GO Zone, the Rita GO Zone, and the Wilma GO Zone, as defined below.

Section 1400M(1) defines the GO Zone as that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster and Emergency Assistance Act (the Stafford Act) by reason of Hurricane Katrina. Section 1400M(2) defines the Hurricane Katrina disaster area as an area with respect to which a major disaster has been declared by the President before September 14, 2005, under section 401 of the Stafford Act by reason of Hurricane Katrina.

Section 1400M(3) defines the Rita GO Zone as that portion of the Hurricane Rita disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Stafford Act by reason of Hurricane Rita. Section 1400M(4) defines the Hurricane Rita disaster area as an area with respect to which a major disaster has been declared by the President before October 6, 2005, under section 401 of the Stafford Act by reason of Hurricane Rita.

Section 1400M(5) defines the Wilma GO Zone as that portion of the Hurricane

Wilma disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Stafford Act by reason of Hurricane Wilma. Section 1400M(6) defines the Hurricane Wilma disaster area as an area with respect to which a major disaster has been declared by the President before November 14, 2005, under section 401 of the Stafford Act by reason of Hurricane Wilma.

IV. RELIEF PROVIDED

A. QUALIFIED REHABILITATED BUILDINGS PLACED IN SERVICE BEFORE HURRICANES KATRINA, RITA, AND WILMA, AND DAMAGED BY THOSE HURRICANES

Taxpayers generally have a reasonable period to repair and restore qualified rehabilitated buildings and to return those buildings to actual service without those buildings being considered permanently retired from service. For qualified rehabilitated buildings located in the GO Zone, the Rita GO Zone, or the Wilma GO Zone that were placed in service prior to the date on which the President declared a major disaster in the area in which the property is located, the Service will deem up to 36 months to be a reasonable period. The period begins on the date that the President declared a major disaster in the area in which the building is located. In order to qualify for this period, the taxpayer must be engaged in the repair or restoration of the qualified rehabilitated building beginning 120 days after the date this notice is published. The term “engaged in the repair or restoration of the qualified rehabilitated building” means, with respect to the building, ongoing physical repairs; having entered into binding, written contracts for

the repair or restoration to be completed within this 36-month period; or, for the period before January 1, 2007, active negotiation of contracts for the repair or restoration.

B. PROPERTIES UNDERGOING REHABILITATION AT THE TIME OF HURRICANES KATRINA, RITA, AND WILMA

In order for buildings to be qualified rehabilitated buildings, they must be substantially rehabilitated. This means that the qualified rehabilitation expenditures during the 24-month or 60-month period selected by the taxpayer must exceed the greater of the taxpayer's adjusted basis in the building or \$5,000. For buildings located in the GO Zone, the Rita GO Zone, or the Wilma GO Zone on which the rehabilitation began, but had not been completed and the building placed in service before the date on which the President declared a major disaster in the area in which the building is located, the running of the 24-month or 60-month period is tolled for a period of 12 months. The period of tolling begins on the date the President declared a major disaster in the area in which the property is located. Qualified rehabilitation expenditures made during the period of tolling are treated as having been made during the relevant 24-month or 60-month period for purposes of determining whether the property is substantially rehabilitated within the meaning of § 47(c)(1)(C).

V. DRAFTING INFORMATION

The principal author of this notice is Patrick S. Kirwan of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Patrick S. Kirwan at (202) 622-3110 (not a toll-free call).